IN THE

Supreme Court of the United States

No. 77-99

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE,
Petitioner,

vs.

BEAR, STEARNS & CO., ET AL.,
Respondents.

RESPONDENTS BOSWORTH, SULLIVAN & CO., INC'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether, under the circumstances and facts as alleged in the present case, Petitioner has a private right of action against Respondent for alleged violations of Regulation T promulgated by the Federal Reserve Board under Section 7 of the Securities Exchange Act of 1934.

STATEMENT OF THE CASE

The Petition involves eight companion cases filed by the Petitioner, Utah State University of Agriculture and Applied Science (hereinafter "The University") against seven corporations or partnerships engaged as broker-dealers in the securities industries (hereinafter referred to as "broker-dealers").

The initiating Complaint was filed on September 20, 1974, alleging that the broker-dealers, among other things, had failed to comply with Section 7 of the 1934 Securities Exchange Act and Regulation T promulgated thereunder by the Board of Governors of the Federal Reserve System.

Identical Motions to Dismiss were filed by eight of the broker-dealers in November of 1974, moving the United States District Court for the District of Utah (hereinafter referred to as the "District Court") to dismiss the Complaints filed against the defendants on all counts, including the counts dealing with margin requirements contained in Section 7 of the Securities Exchange Act and Regulation T promulgated thereunder. One of the broker-dealers, Merrill Lynch, filed a Motion for Judgment on the Pleadings raising issues identical to the Motions to Dismiss.

On July 8, 1975, the District Court dismissed all counts including those involving Regulation T and Section 7 of the Securities Exchange Act.

The District Court reasoned on several theories that the Regulation T counts of the University's Complaints failed to state a claim upon which relief can be granted. First, the Court held that there was no private right of action under Regulation T because of the promulgation of Regulation X, 12 C.F.R. §224.1 (1973), which made unlawful the obtaining by an investor of credit in violation of the margin requirements. Second, the Court held that an implied right of action based upon Regulation T is not available in any event to an institutional investor such as the University. Third, the District Court held that even if a private right of action against the broker-dealers for violations of Regulation T were available to the University, the defense of *in pari delicto* would sustain a Motion for Summary Judgment in favor of the broker-dealers since

the University was equally responsible and liable with them for any alleged margin violations and had available legal counsel from the Utah Attorney General's Office to guide it in its investment program.

The United States Court of Appeals for the Tenth Circuit (hereinafter referred to as the "Circuit Court") affirmed in an unanimous decision, holding that the University had no private right of action against the broker-dealers for violations of Regulation T under the facts pleaded. The Circuit Court did imply, however, that a private action may exist where fraudulent, deceitful or other intentional conduct on the part of broker-dealers is alleged (See Appendix at A-12).

The University petitioned for a rehearing with a suggestion for a rehearing *en banc* which was denied on March 18, 1977.

ARGUMENT

The reasons advanced by the University for granting a Writ of Certiorari in the present case are non-existent because the Circuit Court's opinion relative to Regulation T does not conflict with any other circuit court decision and does not present an important question of federal law which has not been, or should be, settled by this Court.

Furthermore, a review of the Circuit Court's opinion, as well as that of the District Court, reveals a holding harmonious with the legislative intent behind the statutes and regulations involved. Moreover, under the circumstances of the present case, there exists no theory upon which a private right of action in favor of the University could be justified.

A. THE OPINION OF THE CIRCUIT COURT IS NOT IN CONFLICT WITH ANY OTHER CIRCUIT COURT DECISION.

The University asserts the decision rendered by the Circuit Court is contrary to a substantial body of case law which has arisen with regard to the existence of an implied private cause of action under Section 7(c) and Regulation T. In fact, there is no conflict between the circuits on this issue.

The Board of Governors of the Federal Reserve System was authorized by Section 7 of the Securities Exchange Act of 1934 to "prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security." 15 U.S.C. §78g(a) (1971). Accordingly, the Board promulgated margin rules regulating extension of credit by broker-dealers (Regulation T), banks (Regulation U), and other lenders (Regulation G).

Regulation T sets forth the initial minimum margin requirements that brokers and dealers may extend to their customers and, in the case of cash purchases, requires a broker-dealer to make certain that there is sufficient cash in the investor's account within specified time limits.[1] If, after the purchase, payment is not made within the required time, the broker-dealer *must* "cancel or otherwise liquidate the transaction." 12 C.F.R. §220.4(c)(ii)(2) (1973).

Section 7 of the Securities Exchange Act of 1934 was amended by Title III of the Bank Records and Foreign

[1]The required time in the case of a cash account is normally seven business days. 12 C.F.R. §220.4(c)(ii)(2) (1973). However, if a creditor purchases a security for a customer or sells a security to a customer with the understanding that payment is to be forthcoming upon delivery to the customer, the required time may be extended to 35 days. 12 C.F.R. §220.4(c)(ii)(5) (1973).

Transactions Act of 1970 for the purpose of prohibiting the receipt of credit by investors in violation of margin requirements. 15 U.S.C. §78g(f)(1)(1970). In accordance with and pursuant to the amendment the Federal Reserve Board promulgated Regulation X making unlawful the obtaining of credit by an investor in violation of the margin requirements. 12 C.F.R. §224.1 (1973).[2]

The University alleges that the broker-dealers violated Regulation T by not liquidating certain stock-purchase transactions in which payment was not made in the required time under Regulation T and its claims are based on the assumption that the University, as an investor, has an implied cause of action under Regulation T against the broker-dealers. Such a cause of action must be "implied" because Section 7(c) of the Securities Exchange Act of 1934 does not expressly provide a private cause of action for violation of Regulation T or the other margin regulations.

In urging the courts below to recognize such a private cause of action, the University has consistently pointed to various circuit court cases in which courts have held that Section 7 and the margin regulations promulgated pursuant to it may, in appropriate cases, provide a basis for a private cause of action.

The leading case recognizing such an implied cause of action is *Pearlstein v. Scudder & German,* 429 F.2d 1136 (2d Cir. 1970), *cert. denied* 401 U.S. 1013 (1971). In *Pearlstein* the court reasoned that a private cause of action based on Regulation T would have a "salutary policing effect" upon broker-dealers and that knowing participation

[2]Regulation X expressly incorporates the provisions of Regulation T:

> Credit obtained from a broker/dealer shall conform to the provision of Part 220 (Regulation T) of this chapter, which is hereby incorporated in this part (Regulation X). 12 C.F.R. §224.2(a)(2).

of the investor in the activity violative of Regulation T would not bar recovery because the statute only prohibited broker-dealers from extending credit beyond margin requirements and did not forbid customers from accepting the credit. *Id.* at 1141.[3]

However, all of these cases, many of which are relied upon by the University in its Petition, discuss whether an implied cause of action existed under Regulation T prior to the enactment of Section 7(f) in 1970 and the promulgation of Regulation X in 1971.

On the other hand, in this case, the Circuit Court was presented with the question of whether the University, in light of Regulation X, and under the specific facts presented, was entitled to bring a private action against the broker-dealers under Regulation T. Accordingly, the Circuit Court, as well as the District Court, reviewed and analyzed the pre-Regulation X decisions, considered the legislative history behind Regulations T and X[4] and con-

[3]Judge Friendly dissented in *Pearlstein* and argued:

> Even assuming that the purposes of §7(c) would be served by a degree of private enforcement, I question whether the majority's free-wheeling approach will have the desired effect. As a result of it, speculators will be in position to place all the risk of market fluctuations on their brokers, if only the customer's persuasion or the broker's negligence causes the latter to fail in carrying out Regulation T to the letter. *Any deterrent effect of threatened liability on the broker may well be more than offset by the inducement to violations inherent in the prospect of a free ride for the customer who, under the majority's view, is placed in the enviable position of "heads-I-win tails-you-lose."* 429 F.2d at 1148. (emphasis added).

[4]In reaching the conclusion that subsequent to the promulgation of Regulation X, the University has no private cause of action against the broker-dealers, the lower courts both specifically referred to the legislative history behind Regulations T and X and observed that the main purpose for margin requirements is to protect the general economy, not individual investors:

> Congress imposed the margin requirements to protect the general economy, not to give the customer a free ride at the expense of the broker. Appendix at A-13.
>
> [T]he purposes of both regulations (T and X) were aimed at realizing or stabilizing a desirable macro-economic goal of Congress rather than the protection of investors. Appendix at A-25.

cluded that the reasons for allowing private rights of action under Regulation T prior to Regulation X had been seriously undermined by the promulgation of Section 7(f) of the Exchange Act, and Regulation X.[5]

The only circuit court other than the Tenth Circuit which has even discussed the effects of Regulation X upon a private right of action under Regulation T was the Second Circuit Court of Appeals in *Pearlstein v. Scudder & German*, 527 F.2d 1141 (2d Cir. 1975), which involved the remand of the earlier *Pearlstein, supra,* in which the court had recognized a private cause of action under Regulation T. The court stated that a private right of action under Regulation T is "highly questionable" following congressional enactment in 1970 of Section 7(f) and the promulgation of Regulation X in 1971:

> The effect of these developments is to cast doubt on the continuing validity of the rationale of our prior holding. 527 F.2d at 1145, n.3.

Apart from the Second and Tenth Circuits, no other circuit court of appeals has addressed the question of the

Additionally, it was observed that Congress, knowing that for years a private cause of action had been implied under Regulation T and that by implementing Regulation X the rationale for such private actions would be undermined, could easily have authorized a private remedy yet chose not to do so. In this regard the District Court stated:

> [I]t would seem pretentious for this court to expand an area of federal law so recently considered by Congress by "implying" a private damage action for those guilty of margin violations under the law. Appendix at A-28.

[5]A review of *Pearlstein* and the other cases in which a private action under Regulation T was recognized [See, e.g. *Spoon v. Walston & Co., Inc.*, 478 F.2d 246 (6th Cir. 1973) and *Landry v. Hemphill, Noyes & Co.*, 473 F.2d 365 (1st Cir. 1973), *cert. denied* 414 U.S. 1002 (1973)] reveals that the private action was allowed because the investors were not prohibited from accepting credit in excess of the margin requirements and, being thus free from wrongful conduct, were permitted to assist in deterring brokers from extending cedit illegally. However, whatever the merit of such rationale, it was seriously undermined by the promulgation of Section 7(f) of the Exchange Act, 15 U.S.C. §78g(f) (1970), and by Regulation X which placed the responsibility for compliance with the margin requirements on the investor as well as on the broker. See *S.E.C. v. Packer, Wilbur & Co., Inc.*, 362 F.Supp. 510, 515 (S.D.N.Y. 1973).

effect of Regulation X on a private right of action under Regulation T. All circuit cases cited by the University in its Petition pertain to transactions carried out prior to the promulgation of Regulation X.

Thus, there exists no conflict among the circuit courts of appeal concerning the question which the University seeks this Court to review.

Further, the University's assertion in its Petition that the opinion of the Circuit Court is "in conflict with a growing body of district court cases" (Petition, pp. 8, 11-12) is unmeritorious. A review of the district court cases cited by the University reveals (1) that the facts and allegations presented in those cases are vastly different from those presented in this case, and (2) that the opinion of the Circuit Court is harmonious with, not contrary to, the reasoning and opinions in those cases.

The University cites the following district court cases in support of its Petition: (1) *McNeal v. Paine, Webber, Jackson & Curtis, Inc.*, 429 F.Supp. 359 (N.D. Ga. 1977); (2) *Palmer v. Thomson & McKinnon Auchincloss, Inc.*, CCH Fed. Sec. L. Rep. §96,000 (D. Conn. 1977); (3) *Lantz v. Wedbush, Noble, Cook, Inc.*, 418 F.Supp. 653 (D. Alas. 1976); *Neill v. David A. Noyes & Company*, 416 F.Supp. 78 (N.D. Ill. 1976) and *Newman v. Pershing & Co., Inc.*, 412 F.Supp. 463 (S.D.N.Y. 1975).

The *McNeal*, court agreed with the Circuit Court in this case that the additions of Section 7(f) and Regulation X places in doubt the right of an investor to recover for margin violations of its broker. See 429 F.Supp. at 365. It held, however, that a private right of action under Regulation T might still exist where an investor has been affirmatively misled by his broker into believing that his account is in

compliance with Regulation T and, as a result, suffers tangible losses when his broker sells certain stocks at an unfavorable price in order to comply belatedly with the regulation. See 429 F.Supp. at 365.

There were no allegations in this case that any of the broker-dealers affirmatively misled the University. The holding under *McNeal* would also result in the dismissal of this action. Indeed, the Tenth Circuit distinguished *McNeal* on this same ground and held that *McNeal* was inapplicable for that reason.

Similarly, *Palmer* is distinguished from this case because it involved inexperienced small investors who had suffered damages caused, at least in part, by violations of Regulation T committed by a broker-dealer. Such facts are in sharp contrast to this case where the University's experienced investments officer placed and supervised the University's substantial securities transactions and was well aware of the margin requirements to the point of taking advantage of the time limits thereunder. Further, the court in *Palmer* expressly recognized that the promulgation of Section 7(f) and Regulation X thereunder has, at least, had the effect of requiring an investor to "demonstrate his good faith — that he acted innocently without knowledge that the transaction violated the margin requirements" [Fed. Sec. L. Rep. at 91,496 (footnote omitted)] in order to be permitted to bring a private action under Regulation T.

Likewise, the court in *Newman* recognized that subsequent to the promulgation of Regulation X, the continued validity of *Pearlstein* is questionable and expressly rejected the right of a plaintiff investor to bring a private right of action against a broker-dealer for violating Regulation T absent a showing by the investor that the broker-dealer's offer of illegal credit induced the investor to purchase securities which he otherwise would not have acquired.

Lantz and *Neill* are likewise distinguishable from the present case in that both of those cases contained allegations of plaintiff-investors that defendant-brokers had actively misled the plaintiffs or were otherwise guilty of fraud and deceptive conduct regarding compliance with margin requirements. No such allegations are present in this case. In fact, if such allegations had been present in the present action, the Circuit Court indicates that the result reached may have been different:

> *Neill* . . . is not pertinent (in this case) because the complaint alleged fraud and deceptive conduct. See also *Lantz* . . . . Appendix at A-12.

Thus, there being no conflict between the opinion of the Circuit Court and the other Circuit Courts of Appeal or recent district court decisions, Petitioner's first reason for granting a writ of certiorari in this case is without merit and should be rejected.

B. THE QUESTION PRESENTED IS NOT AN IMPORTANT QUESTION OF FEDERAL LAW WHICH SHOULD BE SETTLED BY THIS COURT.

Petitioner contends that this Court should review the question presented because it presents an important question of federal law which has not been, but should be, settled by this Court. As previously stated, this contention is contradicted by the fact that the Circuit Court's opinion dealing with the question is not in conflict with the decisions of the other circuits and in fact, is in agreement with the Second Circuit, the only other Circuit Court of Appeals to even consider the issue.

The administration of both Regulation T and Regulation X will continue and the Federal Reserve Board will

continue to have the right to seek compliance with both Regulation T and Regulation X.

Nor is Petitioner's assertion that the Federal Reserve Board's participation as *amicus curiae* in the Petition for Rehearing before the Circuit Court on this case elevates the question presented to the status of an important question of federal law. The Federal Reserve Board continues to have the right to seek compliance with Section 7 and the regulations promulgated thereunder and the outcome of the question presented will have no effect upon the Federal Reserve Board in the administration and enforcement of those regulations.

Relying on the Circuit Courts of Appeal to effect uniformity in the interpretation of Section 7 should be encouraged. The question presented in this action has only been reviewed in one Circuit Court of Appeals and the fact that other circuit courts may have an opportunity to review the question, if it is presented again, can in no way harm the public interest.

For these reasons, Petitioner's second reason for granting review of the question presented should also be rejected.

C. UNDER THE CIRCUMSTANCES OF THE PRESENT CASE, THERE IS NO BASIS FOR ANY THEORY UPON WHICH THE UNIVERSITY HAS A RIGHT TO BRING A PRIVATE ACTION AGAINST THE BROKER-DEALERS UNDER REGULATION T.

The question presented must be limited to the facts and circumstances of the present case. These facts as presented to the courts below reveal the activities of a well-educated, experienced investments officer of the University who pur-

chased and sold, with written authorization from the University's Board of Trustees, substantial volumes of securities with the assistance of the broker-dealers. Unfortunately, the investments did not fare well. The University sought to recoup its losses by placing liability on the broker-dealers because of alleged violations of Regulation T.

Under such circumstances, the University has no right to bring a private action against the broker-dealers upon any theory. The District Court noted:

> The University, an institutional investor (and an agency of the sovereign) which must operate under guidelines established by statutes, regulations and rules, engaged itself in a far-flung, wide-ranging investment program in common stocks which it now asserts it had no authority to do. Neither the main purpose of section 7(c) — e.g., ". . . to prevent a recurrence of the pre-crash situation where funds which would otherwise have been available at normal interest rates for use of local commerce, industry and agriculture. . . ." — nor the secondary purpose — e.g., the ". . . protection of the small speculator by making it impossible for him to spread himself too thinly. . . ." — are served by implying a private right of action under the facts of this case. . . . The rationale that argues for implying a private right of action for a financially strong institutional investor under either the primary or secondary purpose of section 7(c) hangs from a thin, fragmented thread. *The court is unaware of any authority under which private civil liability should be implied or sustained in this case.* Appendix at 4-30. (emphasis added).

Furthermore, the District Court recognized that even if a private cause of action existed in favor of the University, Regulation X would provide an *in pari delicto* defense which

would sustain a motion for summary judgment in favor of the broker-dealers:

> Regulation X makes the University equally responsible and liable with the defendants for the alleged margin violations. . . . At best, therefore, the plaintiff's theory is novel, in that it seeks to selectively rescind and be made whole on all its loss transactions while keeping the benefits of its gain transactions. *The court is unaware of any authority which would allow such a favorable remedy to a plaintiff who is equally guilty of violation of the regulation under which liability would be imposed against the defendant.* Neither justice nor reason provide grounds on which to sustain a cause of action for the University's theory under all circumstances of this case. Appendix at A-30 & A-31. (emphasis added).

The Circuit Court's opinion is likewise based on and limited to the facts of the present action in which a private cause of action under Regulation T on behalf of the University would not be permitted on any theory.

CONCLUSION

For the reasons set forth above, the Respondent respectfully submits that the University has failed to advance any reasons why this Court should review the question presented in this case. The Petition for Writ of Certiorari should be denied.

Respectfully Submitted,

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